

CHAPTER 5: PROPERTY REQUIREMENTS

5.1 INTRODUCTION

Ensuring that the quality and the value of the property meet certain minimum thresholds is as important as ensuring that the applicant is willing and able to repay a loan. The Agency imposes quality and value requirements to protect the borrower's interest and, in the event of liquidation, the Agency's interest.

A. Overview of Property Requirements

1. *Ensuring Quality*

Four sections of this chapter deal with quality assurance. Section 1 describes the requirements for approving a site -- its location, its size and amenities, and the adequacy of available utility systems. Section 2 describes requirements for the dwelling itself, which must be modest, but also decent, safe, and sanitary. The standards that apply differ somewhat depending upon whether the dwelling will be newly constructed or is an existing home. Section 3 describes the Agency's requirements for the protection of environmental resources and the due diligence required with regard to hazardous substances. Section 6 provides guidance for monitoring construction activities to ensure that any construction or repair work is appropriately conducted and completed.

2. *Ensuring Adequate Value*

Before the Agency makes a loan, the Loan Originator must ensure that the applicant will have an appropriate form of ownership and that the Agency's interest in the property is adequately secured by the value of the real estate and the Agency's lien position. Section 4 specifies Agency security requirements and Section 5 provides guidance on conducting appraisals of the property's value.

B. Key Processing Steps Related to Property Requirements

When applicants locate properties, they must provide the Loan Originator with the basic information needed to initiate the Agency's review of the property. Applicants who do not currently own the property must submit an option or sales contract and a location map with directions to the property. Applicants who already own the property must submit evidence of

ownership, a legal description, a property survey showing all structures on the site, and directions to the property.

1. Preliminary Review

Within 7 days of submission by the applicant, the Loan Approval Official must visit the property to conduct a preliminary evaluation. The Loan Approval Official's review is not intended to take the place of any of the formal reviews that are conducted later. Rather, this evaluation should determine whether, with any planned construction or rehabilitation, it appears the property will meet the Agency's site and dwelling requirements as described in this chapter. Additionally, this site visit is an opportunity to gather initial information which may be used in the completion of the environmental review. Attachment 5-A can serve as a guide for examining existing housing. Attachment 5-B can serve as a guide for site inspections involving new construction.

To determine the potential for impacts to protected environmental resources, the Loan Approval Official must complete an environmental review, as described in Section 3 of this chapter. Occasionally, a proposal may have the potential to have an impact on 1 or more protected environmental resources. In such instances, the Agency is generally required to consult with other Federal agencies, and State or local governments to resolve the issue. If it appears that more than 7 days will be required to satisfactorily complete the environmental review, the Loan Originator must notify the applicant. Applicants should be informed that they may be asked to provide information, or to take certain mitigation measures to help resolve the issue.

The Loan Approval Official also must complete *FEMA Form 81-93, Standard Flood Hazard Determination*, to document whether the property is located in a Special Flood Hazard Area (SFHA) and if so, state the availability of flood insurance. If, through the environmental review process, the Loan Approval Official determines that there is no practical alternative to construction, purchase, or repair in the floodplain, the Loan Approval Official will provide the applicant with *Form RD 3550-6, Notice of Special Flood Hazards, Flood Insurance Purchase Requirements, and Availability of Federal Disaster Relief Assistance*.

If the property appears to be acceptable, the Loan Originator requests an appraisal. If the property is not acceptable, the Loan Originator notifies the applicant and, if the problems cannot be remedied, issues a new *Form RD 1944-59, Certificate of Eligibility*.

2. *Appraisal*

Appraisals may be completed by qualified Agency staff or contract appraisers and are generally completed within 30 days of the request. Depending upon the purpose of the proposed loan, the appraiser may be asked to give an “as-is” or “as-improved” value, or both.

3. *Review of Property and Site for Compliance with Agency Standards*

Before loan approval, the Loan Originator must confirm that the property meets, or will meet with any planned constructions or repairs, all applicable Agency requirements. This is accomplished both through determinations made directly by the Loan Originator and review of opinions or determinations made by others, such as appraisers, local building officials, architectural and engineering professionals, and trades professionals.

4. *Identification and Correction of Deficiencies*

If at any point during the review process, deficiencies are identified that jeopardize the Agency’s ability to approve a loan, the Loan Originator must notify the applicant and give the applicant at least 30 days to resolve the deficiency. For example, if an inspection reveals a structural deficiency that can be corrected, the applicant could negotiate with the seller to reduce the sales price so that funds to correct the deficiency could be included in the loan, or to correct the deficiency before the property is transferred.

If a deficiency cannot be satisfactorily corrected, the Loan Originator notifies the applicant and provides a new *Form RD 1944-59, Certificate of Eligibility*.

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SECTION 1: SITE REQUIREMENTS [7 CFR 3550.56]

5.2 OVERVIEW

Once an applicant has found a property, the Agency needs to ensure that it fits program guidelines regarding sites. The site must be developed according to the development standards imposed by State or local government. These standards are often contained in zoning ordinances, building codes, subdivision regulations, and/or construction standards. Attachment 5-B must be completed in addition to meeting the standards for planning and performing site development work outlined in RD Instruction 1924-C. The Loan Originator, or appraiser, will complete Attachment 5-A or similar guide, to evaluate the acceptability of each site (developed or undeveloped). In particular, sites must be in rural areas, be modest, and meet minimum standards regarding water and wastewater systems, and Agency street and access requirements. This section addresses each of these standards.



5.3 RURAL AREA DESIGNATION

A. Rural Area Definition

Rural areas are defined as:

- Open country that is not part of or associated with an urban area; or
- Any town, village, city, or place (including the immediately adjacent densely settled area) that is not part of or associated with an urban area, and that:
 - ◊ Is rural in character with a population of less than 10,000; or
 - ◊ Is not contained within a Metropolitan Statistical Area (MSA) and has a serious lack of mortgage credit with a population between 10,000 and 20,000.

1. Assessing “Open Country”

A site that is in “open country not part of or associated with an urban area” is one that is separated by open space from any adjacent densely populated urban area. Open space includes undeveloped land, agricultural land, or sparsely settled areas. Open space does not include physical barriers (such as rivers or canals), public parks, commercial and industrial developments, small areas reserved for recreational purposes, and open space set aside for future development.

In order to determine if a property is in open country, the Loan Originator should review recent maps, aerial photographs, and/or conduct a site visit. In particular, the Loan Originator should look for significant new development in parts of rural areas that adjoin nonrural areas, and investigate the likelihood that local authorities may redesignate the area's corporate limits.

2. Assessing "Population"

In order to find the population figures for a locality, the Loan Originator should use the decennial U.S. Census of Population, or population updates published by the U.S. Bureau of the Census.

3. Assessing "Serious Lack of Mortgage Credit"

There is a serious lack of mortgage credit which is readily available to families throughout rural America at rates and terms comparable to those offered by the Agency. Therefore, Agency officials do not need to determine if there is a serious lack of mortgage credit available when determining whether an area is rural, or in reviewing rural area designations.

B. Special Considerations

1. Exception for Rural Areas Designated Prior to October 1990

If an area was classified as rural prior to October 1, 1990, even if it is within an MSA, it may be still considered rural as long as it: (1) has a population between 10,000 and 25,000 and (2) is rural in character. This designation can remain effective through receipt of census data for the year 2000.

2. Contiguous Areas

Two or more towns, villages, cities, or places that are contiguous may be considered separately for a rural designation if they are not otherwise associated with each other, and their densely settled areas are not contiguous.

Paragraph 5.3 Rural Area Designation

When determining the population count for an area, the Loan Originator also should consider developed areas in contiguous counties or states. In cases involving contiguous counties, the appropriate population figure to be used for the area in question should be determined after consultation with the State Director. In an area involving contiguous states, the applicable population figure should be determined through an agreement between the 2 State Directors. The Loan Approval Official should contact both State Directors to help make this determination.

C. Reviewing Rural Area Designations

An area's rural designation may be changed as a result of a periodic review or after the decennial census of population. Both types of review are discussed below. In all cases, the local office should maintain a perpetual master file to document all rural area decisions.

1. Periodic Reviews

Each Field Office must review all areas under its jurisdiction every 5 years to identify areas that no longer qualify as rural. In areas experiencing rapid growth and in eligible communities within MSAs, the review should take place every 3 years. Field Office files must contain documentation that local planning boards, where available, were contacted at the time of each review to verify that areas considered open spaces are not scheduled for development in the next 5 years.

Field Staff must prepare a review report that includes a recommendation on those areas that should be redesignated. An acceptable form for this report is a map showing an outline of the area recommended to be redesignated, and a cover letter explaining the reasons for the recommendation. The review report must be signed by the Loan Approval Official, and submitted to the State Director on or before February 28 of the review year.

Once the review report has been submitted, the State Director will notify the public that the Agency will be conducting a formal review of those areas that have been recommended for redesignation. At a minimum, this notice should be published in local newspapers and posted in local Agency offices. The notice should be published at least 90 days before the date of the final determination in order to give interested parties an adequate chance to comment.

The State Director will make a final determination on designations based on the review report and public comments and notify the Field Office of the final decision.

2. *Census Reviews*

In addition to periodic reviews, the State Director is responsible for implementing redesignations based on the decennial U.S. Census of Population and any biannual updates. Immediately after receiving the population information from the Census Bureau, the State Director must make appropriate changes in designation for areas with populations under 10,000.

3. *Notification of Determination*

By September 30 of each review year, or after the census review is complete, the State Director will distribute a State Supplement that updates, establishes, lists, and maps all ineligible areas. The State Supplement will include county maps showing all ineligible areas in each county. In the official boundary lines of the county map, the State Director will incorporate a “buffer zone” of ineligible areas in the open country designations to compensate for change.



Members of the public should have access to information about ineligible areas through maps posted in the Field Office or handouts that list or show all ineligible areas. If an entire county is ineligible, that information should be posted at the Field Office in a public place and provided to the local news media.

If an area’s designation changes from nonrural to rural (for example, due to a drop in population), public notification is required to ensure that all lenders and other interested parties are made aware of the availability of Agency credit in the newly-eligible area.

4. *Making Loans in Areas Changed to Nonrural*

If an area’s designation changes from rural to nonrural, the Loan Approval Official may approve loans in that area only under the circumstances listed below.

- If an applicant who applied before an area’s designation changed selects a property in the newly designated nonrural area, a loan may be made for that property if it meets all other eligibility requirements.
- New conditional commitments may be issued in nonrural areas if a purchaser is found whose loan application was complete before the area’s designation changed.
- Existing conditional commitments will be honored only if a purchaser is found whose loan application was complete before the area’s designation changed.

Paragraph 5.3 Rural Area Designation

- REO property sales and transfers with assumption may be processed in areas that have changed to nonrural.
- Subsequent loans may be made on a property that already has an Agency loan to: (1) make necessary repairs; (2) to pay equity in connection with an assumption of the Agency loan; or (3) to pay equity to a departing coborrower.

5.4 MODEST SITES

Modest sites are defined by their size, value, and the presence of any outbuildings. Therefore, the Loan Originator must verify that the requirements listed below are met.

- **Size.** The site must not be large enough to be subdivided under local subdivision regulations.
- **Value.** The value of the site must not exceed 30 percent of the as-improved market value of the property. The 30 percent limitation may be exceeded if the site cannot be subdivided into two or more sites and the value of the site is typical for the area, as evidenced by the appraisal and the practices of other lenders.
- **Farm Buildings.** The property must not include farm service buildings (although smaller outbuildings such as storage sheds are allowed), or must be readily salable with the farm buildings.

5.5 ADEQUATE WATER AND WASTEWATER SYSTEMS

The site must have water and wastewater disposal systems, whether individual, central, or privately-owned and operated, that meet the applicable water and wastewater disposal system requirements of RD Instruction 1924-C. There must be assurance of continuous service at reasonable rates for central water and wastewater disposal systems. A system owned or operated by a private party must have a legally irrevocable agreement which allows interested third parties to enforce the obligation.



Private companies usually inspect individual wells and septic system drainfields -- these companies provide written results of the inspection. In addition, the responsible local or State regulatory agency must verify, in writing, that the privately-owned water and wastewater disposal systems comply with the Safe Drinking Water Act (42 U.S.C. 300h) and the Clean Water Act (33 U.S.C. 1341), respectively. Inspections are not required on public water and wastewater disposal systems.



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SECTION 2: DWELLING REQUIREMENTS [7 CFR 3550.57]

5.6 MODEST HOUSING

To be considered “modest,” the cost of a property must not exceed the cost of other modest housing in the area and must not have certain prohibited features.

A. Section 203(b) Limits

In order to be considered modest, the cost of a dwelling financed with an Agency loan cannot exceed the maximum dollar limitation established under section 203(b) of the National Housing Act (10 U.S.C. 1709). This limit applies to the value of the site, if already owned by the applicant, and all the funds used to purchase the dwelling, including the applicant’s own funds or funds from another lender.



The section 203(b) limits are established based on the cost of modest housing in an area. Unless a property contains one of the features expressly prohibited in Paragraph 5.6 B., a property that costs no more than this limit will be considered modest, regardless of its specific features. Appendix 10 lists the section 203(b) limits.

Exceptions may be granted to allow the amount of a loan to exceed the section 203(b) dollar limitation if the existing section 203(b) mortgage limit is not sufficient to provide adequate housing for applicants in certain areas or for individual applicants.

1. *Area-Wide Exceptions to the Loan Limits*

Area-wide exceptions may be granted when the section 203(b) limit is insufficient to provide adequate modest housing, or where different maximum loan limits exist in adjacent areas of the same community. Requests for area-wide exceptions may be approved by the State Director if the limit is to be increased by \$10,000 or less. Larger increases must be approved by the Deputy Administrator, Single Family Housing.



Effects of the Section 203(b) Limits

Cost of the Property. The cost of the property, including the combined costs paid for by the Agency loan, loans from other sources, or the applicant’s own funds, and the value of a site already owned by the applicant, cannot exceed the section 203(b) limit.

Maximum Loan Amount. The loan an applicant receives must not exceed the section 203(b) limit, unless the applicant chooses to finance the appraisal fee, tax monitoring fee, or the initial contribution to fund the escrow account, in which case the loan can exceed the section 203(b) limit by the cost of these items and with approval by the State Director.

Requests for area-wide exceptions must be accompanied by evidence that the Field Office is working with the appropriate office of the U.S. Department of Housing and Urban Development (HUD) to increase the section 203(b) limit, and must be supported by a market analysis that demonstrates the need for the exception. Exhibit 5-1 provides guidance for conducting a market analysis.

Exhibit 5-1**Conducting A Market Analysis**

The market analysis must provide information on all single family properties sold in the area during the past month. If fewer than 150 homes were sold during that period, the analysis must include information on single-family homes sold during the past 2 months. Only arm's-length transactions may be included. Paper transactions, distressed sales, foreclosure sales, lot sales, and refinancings must not be included. Sales must be listed in order from the lowest sales price to highest, with each sale numbered. The data must include:

- A copy of the Multiple Listing Service (MLS) listing or other information that provides the characteristics of the dwelling, plus a recent photograph of the home, if one is available;
- The address of the property;
- The month and year of the sale;
- The sales price;
- Whether the property was an existing home or new construction; and
- Any conditions of sale that are not considered customary to convey title.

2. Individual Exceptions to the Loan Limits

Individual exceptions may be granted to accommodate the specific needs of an applicant, for example, to serve exceptionally large households or to provide reasonable accommodation for a household member with a disability. The exception can be granted by the State Director if the limit is to be increased by \$10,000 or less, and by the Deputy Administrator, Single Family Housing if the increase is larger than \$10,000.

To request the exception, the Loan Originator must:

- Document the need for the exception;

Paragraph 5.6 Modest Housing

- Justify the amount of the exception. For a large household, provide a market analysis that shows typical costs for the type and size of dwelling that is required to meet the needs of the household. For accommodations for household members with disabilities, provide the cost of accommodations and a market analysis that demonstrates that these costs cannot be accommodated within the section 203(b) limits; and
- Document the request and, if approval is granted, follow UniFi procedures for overriding the maximum mortgage limits.

Individual exceptions also can be granted for subsequent loans that exceed the section 203(b) limits if necessary to protect the Government's interests. The State Director can authorize subsequent loans that exceed the section 203(b) limits to accommodate the cost of necessary repairs, reasonable closing costs, and allowable excess costs (including the appraisal fee, tax monitoring fee, and initial deposit to fund the escrow account), without authorization from the Deputy Administrator, Single Family Housing, even if the increase exceeds \$10,000.

B. Prohibited Features

1. Swimming Pools

Agency loans cannot be used to finance properties that include in-ground swimming pools. It is not acceptable to remove a pool before or after closing in order to meet this requirement.

2. Income-Producing Land Or Structures

Agency funds cannot be used to purchase or improve income-producing land, or buildings designed to accommodate a business or income-producing enterprise. Home-based operations such as child care, product sales, or craft production that do not require specific features are not restricted.

5.7 DECENT, SAFE AND SANITARY DWELLINGS

To help ensure that dwellings are “decent, safe, and sanitary,” the Agency has established minimum standards for new and existing dwellings.

A. Existing Dwellings

Existing dwellings must be structurally sound and functionally adequate, and be in good repair or be placed in good repair with loan funds. If the loan does not exceed \$7,500 and the repayment schedule does not exceed 15 years, the dwelling may lack some equipment or features after repairs such as a complete bath, kitchen cabinets, closets, or completed finished interior in some rooms. These dwellings must otherwise meet the housing needs of the applicant and provide decent, safe, and sanitary living conditions when the improvements financed with the loan are completed.

To verify that all major systems are adequate State-licensed inspectors must certify that the dwelling has been inspected and meets Agency standards with respect to: (1) thermal performance; (2) termites and other pests; (3) plumbing, water and sewage; and (4) heating and cooling; (5) electrical systems; and (6) structural soundness. When a State does not license inspectors, a qualified, independent, third-party inspector may provide these certifications.

B. New Construction

All construction must meet the standards contained RD Instruction 1924-A. The process for ensuring that the Agency's construction standards are met is described in Section 6 of this chapter.



C. Survey Requirements

A survey is required for any property which is currently not financed by the Agency. The Loan Originator must review a survey to ensure that all existing and proposed structures are or will be located on the site. In addition, for loan closing, title insurance must contain survey coverage. Therefore, the Loan Originators should ensure that any new or existing survey meet the requirements of the title company. When a new survey is needed, it must contain boundary lines, any improvements, encroachments on the subject or adjacent property, above-ground easements, set-backs either imposed by either restrictive covenant or zoning, and any additional requirements needed to obtain title insurance. For new construction, the boundary corners must also be clearly marked. An existing survey may be used if it meets the requirements of the title insurance.

D. Flood-Related Requirements

For all new construction and substational improvements within the 100-year flood plain, the lowest floor (including basement) must be elevated to or above the 100-year flood level, unless FEMA has granted an exception as part of the community's flood plain management regulations. For existing dwellings, the first floor elevation of the habitable space must be at or above the 100-year (base) flood level. All dwellings within the 100-year flood plain must be served by public utilities that are located and constructed to minimize or eliminate flood damage, or have an on-site water supply and waste disposal system located and constructed to avoid contamination of the water supply by the septic system due to flooding. In addition, for newly constructed and substantially rehabilitated dwellings, the construction materials and methods used must be for the purpose of making the structure resistant to flood damage, and minimizing any damage that may occur. RD Instruction 426.2 contains further guidance on the National Flood Insurance Program and flood-related requirements.

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SECTION 3: ENVIRONMENTAL REQUIREMENTS

[7 CFR 3550.5]



5.8 PROTECTION OF ENVIRONMENTAL RESOURCES

The Agency considers environmental quality equally with economic, social, and other factors in its program development and decision-making processes. The environmental review process is intended to help Agency officials make decisions that are based on an understanding of the environmental consequences of a proposed action, and to take those actions that protect, restore, and enhance the environment.

This paragraph contains a general discussion of basic environmental requirements. Detailed environmental policies and procedures can be found in RD Instruction 1940-G, which contains compliance requirements for the National Environmental Policy Act (NEPA), as well as numerous other laws, Executive Orders, and Departmental regulations on a variety of other environmental issues.



Environmental Library

At a minimum, each Field Office should maintain the following information in order to facilitate completion of environmental reviews. The State Environmental Coordinator can provide assistance in obtaining or understanding this information.

- The State's Natural Resource Management Guide;
- Federal Emergency Management Agency (FEMA) floodplain maps;
- Natural Resources Conservation Service (NRCS) Soil Surveys and Important Farmland Soils; and
- U.S. Fish and Wildlife Service (USFWS) Coastal Barrier Resource System maps (as applicable).

A. Types of Environmental Reviews

NEPA requires that Agency actions be classified into 3 basic categories of actions: those that normally qualify as categorical exclusions and generally require the preparation of a brief checklist; those that normally require an environmental assessment (EA); and those that normally require an environmental impact statement (EIS). Due to the wide range of activities funded by the Agency, it has been allowed to establish 2 categories of actions requiring an EA: Class I actions, requiring an EA with limited detail and analysis; and Class II actions, requiring a fully detailed EA. This classification of actions provides the Agency with a starting point for beginning its environmental review. Most single family housing activities will qualify as a categorical exclusion; some will qualify for a Class I EA. For a complete list of housing actions and their classifications, refer to RD Instruction 1940-G.



1. *Categorical Exclusions*

A categorical exclusion is an action that does not, individually or cumulatively, have a significant impact on the quality of the human environment, and therefore requires neither an EA nor an EIS, unless an extraordinary circumstance or cumulative impacts are involved. For each proposed action, a brief checklist, *Form RD 1940-22, Environmental Checklist for Categorical Exclusions*, is prepared to ensure that the specific proposal under consideration does in fact qualify as a categorical exclusion and that there are no extraordinary circumstances or cumulative impacts.

In general, extraordinary circumstances are considered to exist when the proposed action is or will be located on or near and/or has the potential to affect environmentally sensitive land uses or resources. Exhibit 5-2 provides a listing of the most common land uses and resources that must be considered. RD Instruction 1940-G contains detailed information on the proper implementation of requirements affecting categorical exclusions.



Exhibit 5-2	
Environmentally Sensitive Land Uses and Resources	
Wetlands	Natural Landmarks
Floodplains	Important Farmland
Wilderness Areas	Prime Forest Land
Wild or Scenic Rivers	Prime Range Land
Historical, Archeological Sites	Coastal Zone Management Area
Critical Habitat or Endangered or Threatened Species	Sole Source Aquifer Recharge Area
Coastal Barriers	State Water Quality Standard

2. *Environmental Assessment*

If it appears that extraordinary circumstances and/or cumulative impacts may be involved, a Class I EA must be prepared using *Form RD 1940-21, Environmental Assessment for a Class I Action*. Through this form, the Agency provides the necessary documentation to: (1) demonstrate compliance with requirements for protection of the resource, including the development of practical alternatives to either avoid or lessen the environmental impact; and (2) demonstrate why the potential impact on the resources is not considered to be significant and therefore, an EIS is not required.

B. Flood Hazard Determination

FEMA Form 81-93, Standard Flood Hazard Determination, states whether or not the property is located in a Special Flood Hazard Area (SFHA) identified by FEMA and, if so, states the availability of flood insurance for this property through FEMA's National Flood Insurance Program (NFIP). The form may be prepared by Agency staff or by a contract service. Property in a SFHA is ***not eligible*** for Federal financial assistance unless flood insurance through the NFIP is available. The information regarding floodplains on this form will assist in the preparation of the environmental review document, which must examine whether or not there is a reasonable alternative to a proposed purchase/construction in a floodplain.

C. Responsibility for Environmental Reviews

The Loan Originator is responsible for completing the appropriate level of environmental review. This includes the assembly and analysis of relevant material, the development and analysis of practical alternatives and mitigation measures (as appropriate), and the development of recommendations regarding environmental impacts and environmental compliance. Applicants may be requested to provide information needed for the analysis.

The Loan Approval Official will use the environmental review documents and, as appropriate, the recommendations of the State Environmental Coordinator, to make the Agency's final decision regarding an environmental impact determination and compliance with environmental requirements, as well as flood insurance requirements. This decision is evidenced by execution of the "Finding" on *Form RD 1940-22*, for categorical exclusions or by execution of the Finding of No Significant Impact for EAs.

State Environmental Coordinators are available to provide technical assistance and guidance. They also are available to assist in problem resolution on environmental issues. Environmental questions or problems should be referred promptly to the State Environmental Coordinator.

5.9 MANAGEMENT OF HAZARDOUS SUBSTANCES

The Agency must consider the management of hazardous substances, including hazardous wastes and petroleum products, from two perspectives: liability under hazardous substance and hazardous waste laws, and the economic risks posed by the presence of hazardous substances. Both of these issues are addressed through due diligence. Due diligence is the process of inquiring into the environmental condition of real estate, in the context of a real estate transaction, to determine the presence of contamination from hazardous substances, including hazardous wastes and petroleum products, and to determine what impact such contamination may have on the market value of the property.

When visiting a property, Agency staff members should be alert for any indication that hazardous substances might be present. Appraisers also are required to notify the Agency if they observe contamination from hazardous substances, or if information from research or interviews with individuals knowledgeable about the property indicates that the property might contain hazardous substances.

If an Agency staff member or an appraiser notices that a property may contain hazardous substances, or if the Agency has any other reason to suspect that a property is contaminated, the Loan Approval Official must initiate a due diligence review by completing the Transaction Screen Questionnaire, ASTM Standard E-1528 (TSQ), the initial level of inquiry in the due diligence process. If the completed TSQ raises any concerns, it must be sent to the State Environmental Coordinator for further evaluation and guidance.

SECTION 4: SECURITY REQUIREMENTS

5.10 ACCEPTABLE MORTGAGE

Generally, there should be no non-Agency liens on the property at the time of or immediately after closing, unless they are part of a formal leveraging strategy, or the Agency loan is for essential repairs and a senior lien secures an affordable non-Agency loan. However, the Loan Originator may accept prior or junior liens as long as: (1) the lien will not interfere with the purpose or repayment of the Agency loan; (2) the total value of all liens on the property is less than or equal to the property's market value; and (3) the prior lien does not contain provisions that may jeopardize the Agency's security position or the applicant's ability to repay the loan.

5.11 OWNERSHIP REQUIREMENTS [7 CFR 3550.58]

If the applicant defaults on the loan, the Agency must be able to foreclose on the property to settle the debt. Therefore, after the loan is closed, the applicant must have an ownership interest in the property that is acceptable to the Agency.

A. Responsibilities

In preparation for closing, the closing agent selected by the applicant must review the ownership interest the applicant will have to ensure that it meets the requirements established by the Agency in RD Instruction 1927-B. The closing agent must also ensure that the form of ownership conforms with the requirements of relevant State laws. After closing, the Loan Originator should compare the deed of trust or mortgage with the title opinion to assess lien priority, to verify recordation of the date and time, and to ensure that the loan closing instructions have been followed.



B. Acceptable Forms of Ownership

Several forms of ownership are acceptable to the Agency, but in all cases the applicant's ownership interest must be carefully documented.



1. Fee-Simple Ownership

The most common form of ownership is fee-simple ownership, under which the borrower holds a fully marketable title to the property. This title is evidenced by a deed that vests full interest in the property to the borrower.

Land Purchase Contracts

When the ownership interest is by virtue of a land purchase contract, the ownership interest must be converted to a deed/mortgage interest prior to closing the loan.

2. Secure Leasehold Interest

Although fee-simple ownership is preferable, the borrower may have a secure leasehold interest in the property. Leasehold interests are acceptable only when all of the following conditions apply.

- The applicant must be unable to obtain fee-simple title to the property, and the rent charged for the lease must not exceed the rate being paid for comparable leases.
- The lessor must own the fee-simple title (this provision does not apply to a lessor who is an American Indian possessing a leasehold interest on tribal allotted or trust land).
- Neither the leasehold nor the fee-simple title may be subject to a prior lien unless the Agency authorizes acceptance of the prior lien before loan approval. The amount of the Agency's loan, plus any prior liens, must not exceed the market value of the property including the value of the leasehold.
- The lease must be in writing, and must contain ***all*** of the following provisions:
 - ◇ The lessor's consent to allow the Agency's mortgage;
 - ◇ The right of the Agency to foreclose and sell the property without restrictions that adversely affect the market value of the property;
 - ◇ The right of the Agency to bid at a foreclosure sale or to accept voluntary conveyance of the property in lieu of foreclosure;

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- ◇ The right of the Agency to occupy, sublet, or sell the property should the leasehold be acquired through foreclosure, voluntary conveyance, or abandonment;
 - ◇ The right of the applicant to transfer the leasehold and Agency mortgage to an eligible transferee who will assume the Agency's debt, if the borrower defaults or is unable to continue with the lease;
 - ◇ Advance written notice of at least 90 days to the Agency of the lessor's intention to cancel or terminate the lease;
 - ◇ Provisions are negotiated with the lessor before the leasehold interest is approved regarding the Agency's obligation to satisfy unpaid rent or other charges accrued before or during the time the Agency has possession of or title to the leasehold. During negotiations, the Loan Originator should consider the length of time it will take to foreclose, how much the Agency would be responsible for, and when the Agency would have to pay;
 - ◇ Provisions to ensure fair compensation to the borrower for any part of the property taken by condemnation; and
 - ◇ The unexpired term of the lease must be at least 150 percent of the term of the mortgage, unless the loan is guaranteed by a public authority, Indian Tribe, or Indian Housing Authority. For guaranteed loans, the unexpired term of the lease must be at least 2 years longer than the mortgage term. In no case may the unexpired term of the lease be less than 25 years.
- The language, specified in Attachment 5-C, must be inserted in the mortgage.

3. Life Estate Interest

The applicant may hold a life estate interest with the rights of present possession, control, and beneficial use of the property. All persons with any remainder interests in the property must be signatories to the mortgage, except as described in Paragraph 5.11 B.4.

4. *Undivided Interest*

To be eligible for a loan if an applicant only has an undivided interest in the land, co-owners must also be unable to provide or obtain the financing for the improvements, either individually or jointly with the applicant. Generally, all legally competent co-owners must sign the mortgage. However, when one or more of the co-owners cannot be located, are not legally competent (and there is no legal representative who can sign the mortgage), or if the ownership interests are divided among so many co-owners that it is not practical to mortgage all of their interests, their interests may be excluded from the security requirements, as long as their interests do not exceed 50 percent of the property's value.

The maximum loan amount is the percentage of the market value that is proportional to the percentage of the property interest owned by all persons signing the mortgage. The determination of market value should take into account any adverse effects that might result from selling mortgaged interests separately from nonmortgaged interests.

Only the State Director may approve the exclusion of co-owners' interests. The Loan Originator or the Loan Approval Official should prepare a recommendation for the State Director's review. The memo should include a full statement of ownership and the reasons for the proposed exclusion.

5. *Possessory Rights*

Possessory rights on an American Indian reservation or State-owned land, and the interest of an American Indian in land held in trust or deeds containing restrictions against alienation are acceptable forms of interest as long as the trust or restricted land will remain in trust or restricted status.

Tribal Allotted or Trust Land

Tribal allotted or trust land must remain in trust or restricted status. In these cases, the mortgage, deed of trust, leasehold interest or other security interest must be approved by the Secretary of the Interior. Each State should issue a supplement to give guidance about making loans under these circumstances.



5.12 EXCEPTIONS TO THE AGENCY'S SECURITY REQUIREMENTS

Exceptions may be made under the circumstances described below.

A. Unsecured (Note Only) Loans

A loan of \$2,500 or less that is scheduled for repayment within 10 years from the date of the loan may be secured by a promissory note alone as long as the applicant:

- Has a credit history that indicates an ability and willingness to pay the debt when due;
- Has principal, interest, taxes, and insurance (PITI) and total debt (TD) ratios that indicate that the applicant will have sufficient income to meet all obligations; *and*
- The applicant's equity in the real estate, as improved, equals or exceeds the amount of the proposed loan.

In order to verify the above conditions, the Loan Originator should review the applicant's credit history, as described in Section 3 of Chapter 4, except that the Loan Originator should not order a mortgage credit report. The applicant cannot receive payment subsidy on an unsecured loan.

B. Best Mortgage Obtainable

Except for unsecured loans described in Paragraph 5.12 A., loans of \$7,500 or less and subsequent loans provided to make minimal essential repairs necessary to protect the Government's interests, must be secured by a mortgage. However, title clearance and the use of legal services as required by RD Instruction 1927-B are not necessary, unless the Loan Originator determines there are doubts about the form of ownership held by the borrower.



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SECTION 5: APPRAISALS [7 CFR 3550.62]

5.13 OVERVIEW

High-quality appraisals are key to ensuring that the Agency obtains adequate security for its loans. This section provides guidance about the types of appraisals that may be needed, when appraisals are required, how they are ordered, and how they must be reviewed. Detailed guidance on how appraisals are done for the Agency are contained in Appendix 5. This appendix can be provided to contract appraisers as guidance for developing acceptable appraisals for the Agency.

5.14 TYPES OF VALUE

Depending on the purpose of the proposed loan, an appraiser will either give the estimated value of the property in its current condition (the “as is” value) or, based on construction plans and specifications, give the estimated value of the property after development (the “as improved” value). Occasionally, both values will be required. The circumstances under which each type of value is required are as follows.

- **As improved value.** Loans for construction require an estimate of the as improved value.
- **As is value.** Loans for existing dwellings requiring no repairs requires an estimate of as is value. As is appraisals may also be needed to support loan servicing action or to determine a disposition plan for Real Estate Owned (REO) property.
- **As is and as improved.** When repairs to an existing dwelling or REO property are planned the appraisal should provide both “as is” and “as improved” value estimates.

5.15 APPRAISAL METHODOLOGY

Real estate appraisers make judgments about a property’s value based on many factors, including location, market conditions, construction quality, and amenities. The Agency requires appraisers to use 2 appraisal methods to arrive at a final estimate of value.

- **Sales comparison approach.** Under this method, the appraiser uses the recent sales prices of properties that are comparable in location and characteristics to the security property in order to estimate a market value for the property.
- **Cost approach.** Under this method, the appraiser derives an estimate of value using standard estimates of the construction cost for the dwelling and an estimate of the site value.

In most cases the appraiser uses *Form RD 1922-8, Uniform Residential Appraisal Report* to conduct both the sales comparison and cost estimates. However, if the property is a new property, an existing property that is less than 1 year old, the appraiser must use *Form 1007, Marshall and Swift Square Foot Appraisal* to arrive at a value using the cost approach. *Form 1007* also should be used for existing properties if strong comparables are not available.

5.16 ORDERING APPRAISALS

A. When Appraisals Are Needed

An appraisal is always required if the loan exceeds \$15,000. (Another lender's appraisal is acceptable when the loan is part of a leveraging strategy.) If the loan amount is less than or equal to \$15,000, an appraisal is not required if the Loan Originator is confident that the property has sufficient value to serve as adequate security. The Loan Originator should include a statement of the property's value in the case file whenever an appraisal is not completed.

For subsequent loans, no appraisal is required if the loan is for \$5,000 or less and is for minimal essential repairs needed to ensure that the dwelling is decent, safe, and sanitary. An appraisal is not required when a subsequent loan is made to protect the Government's interest, regardless of the amount. The Loan Originator must include a statement of the estimated property value in the case file. If the subsequent loan is for more than \$5,000, no appraisal is needed unless the property will be taken as security and at least 1 of the following conditions exists:

- The latest appraisal report of the real estate is over 2 years old;
- The physical characteristics of the property have changed significantly;
- The Loan Originator is uncertain of the adequacy of the security; or
- The subsequent loan is in connection with a transfer of an existing loan.

Paragraph 5.16 Ordering Appraisals

B. Required Information

When the Loan Originator orders an appraisal, the appraiser should be provided with: (1) a copy of the option or sales agreement, with a legal description of the property; (2) a direction map; (3) certified building plans and specifications, and repair estimates, if applicable; (4) existing surveys; (5) a copy of the existing title; and (6) tax bills or assessments.

The applicant has until the expiration of their Certificate of Eligibility, as described in Paragraph 7.17, to present this information to the Loan Originator. Originals of this information should be kept in the case file, with copies provided to the appraiser.

C. Abbreviated or Revised Appraisals

Generally, a Complete Appraisal in Summary Form will be made for each property appraised as required by the Uniform Standards of Professional Appraisal Practice (USPAP). However, in certain cases it may be appropriate to depart from the non-binding provisions of Standard 1 of USPAP and complete a Limited Appraisal in Restricted Form.

1. Abbreviated Appraisals

Identical dwellings built in the same subdivision and on equally desirable sites should have similar market value. If a property to be appraised is identical to one appraised within the past 90 days, an abbreviated appraisal is acceptable if the departure provision of USPAP can be invoked and a Limited Appraisal in Restricted Form completed. The appraisal must state what provision of USPAP is being departed from and the reason for the departure.

2. Revised Appraisals

Existing appraisals may be revised in accordance with USPAP without making a full new appraisal when: (1) the appraisal is not more than one year old; (2) no substantial changes have been made to the property since the previous appraisal; (3) adequate documentation is attached to support the revised estimate of value; and (4) the revision must be conducted by the same appraiser/firm who performed the original appraisal. Revised appraisals may either be Complete Appraisals in Summary Form or Limited Appraisals in Restricted Form depending on the level of documentation utilized in revising the appraisal. The revised appraisal must always be filed with the original appraisal.

D. Timelines

The Loan Originator should order appraisals within 3 business days of receiving notification from the Loan Originator that the property appears to be acceptable. Depending on the State, appraisals are conducted by either in-house Agency staff, or private appraisers under contract to the Agency. In-house appraisals are to be completed within 30 days of receiving the appraisal order. Contract appraisals are to be completed within the time specified in the contract, which generally does not exceed 30 days.

5.17 APPRAISER RESPONSIBILITIES

The appraiser must provide the required estimates of value on the appropriate form. The appraiser also may be asked to provide a list of repairs deemed essential for the property to be made decent, safe, and sanitary.

If an appraiser observes potential contamination from hazardous substances, hazardous wastes, or petroleum products on the property, or obtains other information about such contamination, that information should be provided to the Agency together with an indication of its potential impact on the value of the property. The Loan Originator must initiate the due diligence process by completing a *Transaction Screen Questionnaire (TSQ)*, *ASTM E-1528*. The completed TSQ must be sent promptly to the State Environmental Coordinator for further evaluation and guidance.

In-house appraisers also must complete *Form RD 1922-12, Nonfarm Tract Comparable Sales Data* for each comparable property considered. The in-house appraiser may use data from existing copies of *Form RD 1922-12* in conducting the sales comparison approach if the information contained on the form is current and appropriate.

5.18 REVIEWING APPRAISALS

Appraisals will be reviewed for accuracy through a combination of administrative review and random spot-checks by State Appraisal Staff and Field Staff who have been assigned to this task by the Loan Approval Official. If an appraisal is found to be unacceptable by any review, a new appraisal must be ordered and acceptably completed before the loan-making process can continue.

Paragraph 5.18 Reviewing Appraisals

A. Administrative Review

Administrative reviews are performed by the Loan Approval Official and are the least detailed of the reviews. They are to be performed on all contract/fee appraisals and the contract appraiser's invoice cannot be paid until the appraisal review is complete. This review determines whether the appraisal is complete, the mathematics is correct, the proper number of current comparables has been used, and that both the cost and the comparable sales approaches were used to establish market value. *Form RD 1922-15, Administrative Appraisal Review for Single Family Housing* should be used for this review. Once completed, the form should be signed, dated, and forwarded to the State Appraisal Staff. The review should be completed as soon as possible, but must be completed within 7 days of receipt of the appraisal.

B. Technical Review

A technical review is performed to determine whether the appraisal was complete, was clearly reasoned, and had adequate support for the conclusion of value. Technical reviews are performed in the State Office or by Field Staff assigned by the Loan Approval Official. *Form RD 1922-14, Residential Appraisal Review for Single Family Housing* is used for a technical review.

Technical reviews are completed for the first appraisal conducted by any contract or fee appraiser. At the discretion of the State Appraisal Staff, additional technical reviews may be ordered if problems were encountered on the first technical review. In addition to the initial review, technical reviews will be done in a random, spot-check method established by the State Director for both contract and in-house appraisals.

A technical review also may be requested by the Loan Approval Official when problems are detected by the administrative review. These problems must be significant and result in an appraisal that does not support the concluded value. The problems will be documented on *Form RD 1922-15*. The State Appraisal Staff must determine whether a technical review is merited before the appraiser can be paid or the loan approved.

C. Field Review

Field reviews involve on-site visits to the subject property and the comparables, and are completed by State Appraisal Staff on a random, spot-check basis to determine whether the contract or fee appraiser has followed accepted appraisal techniques and arrived at a logical conclusion. When an applicant appeals the results of an appraisal, a field review will be completed prior to the appeal hearing. *Form RD 1922-14* is used for field reviews, as well as for technical reviews.

5.19 PAYING FOR APPRAISALS

The Agency will charge a \$280 fee for each loan application that requires an appraisal. Within 3 business days of receiving a completed application, the Loan Originator will provide the applicant with *Form RD 440-58, Estimate of Settlement Costs*, which includes the amount of the appraisal fee.

At the applicant orientation described in Paragraph 8.6 A.1., the applicant must decide whether to finance the appraisal fee or pay it out of their own funds. If the fee is financed, the Loan Originator should include it in *Form RD 1940-41, Truth in Lending Statement*. In these cases, the total indebtedness may exceed the property value and section 203(b) limit by the amount of the appraisal fee.



The Agency may waive the fee for appraisals done for subsequent loans needed to make minimal, essential repairs necessary to protect the Government's interest, or for leveraged loans if a participating lender is obtaining an appraisal that is acceptable to the Agency.

If there is a conditional commitment, the appraisal fee should be paid to the contractor at closing as reimbursement for the cost of the appraisal that was included in the conditional commitment fee.

5.20 APPRAISALS IN REMOTE RURAL AREAS OR TRIBAL LANDS

In remote rural areas and on Tribal lands, a lack of comparables can make it difficult to appraise a new construction property. In these areas, the sales comparison approach is not required. Instead, *Form 1007, Marshall and Swift Square Foot Appraisal* must be used. These appraisals must be conducted by Agency staff with appraisal authority; they cannot be done by contract appraisers.

Remote rural areas are identified by the State Director and are defined as areas with all of the following characteristics:



- Scattered population;
- Low density of residences;
- Not part of an MSA;
- Lack of basic shopping facilities;

Paragraph 5.20 Appraisals in Remote Rural Areas or Tribal Lands

- Lack of community and public services and facilities; and
- Lack of comparable sales data.

The results of the cost analysis done using *Form 1007* should be documented on *Form RD 1922-8, Uniform Residential Appraisal Report*, and efforts to obtain comparable market data must be documented in lieu of the sales comparison approach. External depreciation based on the remoteness of the site must not be considered; however, factors that impact the site such as immediate proximity to a feedlot, factory, or other similar considerations should be included. When a market is established in these areas, the Agency will again require complete appraisals including sales of comparable Agency-financed properties.

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SECTION 6: MANAGING CONSTRUCTION

5.21 DESIGN

A. Disseminating the Standards

The applicant needs to know the standards the dwelling must meet before the design process begins. The Loan Originator should advise the applicant of the Agency's rehabilitation or construction standards.

The applicant and/or designer should also be provided with *Form RD 1924-2, Description of Materials*, prior to loan approval. This form may be used by the designer as a basis for preparing specifications. When other suitable specifications are available which will adequately describe the materials, equipment, and fixtures to be used on the job, this form need not be used.

B. Review and Approve the Drawings and Specifications

Once the drawings and specifications are finished, the Loan Originator should review them to ensure that they have been certified as meeting the Agency's minimum standards contained in RD Instruction 1924-A. The plans, specifications, calculations, and any modifications should be certified by the design professional on *Form RD 1924-25, Plan Certification*, to ensure that the appropriate codes and standards are met. If all applicable requirements are met, the Loan Originator may accept the documents. If they do not meet the applicable requirements, the Loan Originator should inform the applicant and designer, in writing, of the deficiencies or discrepancies. Once these issues are resolved, the Loan Originator should review the drawings and specifications again.



5.22 PREPARING FOR CONSTRUCTION

A. Selecting the Contractor


The applicant should then select the contractor who will build or rehabilitate the dwelling. For new construction, the applicant will usually have a contractor in mind. For rehabilitation, the applicant should solicit a minimum of 3 bids, if possible. Acceptable bids must include a complete breakdown on materials and labor and describe the quantity, quality, sizes, grades, styles, model numbers, etc. to clearly identify the work and materials to be furnished. Occasionally, the applicant may need help to find a suitable contractor. If the Agency maintains a list of contractors, this list can be provided.

If the applicant selects a contractor with whom the Field Office is not familiar, the Loan Originator should:

- Interview the contractor and inspect homes they have recently built;
- Obtain a certified financial statement;
- Obtain, at the contractor's expense, a commercial credit report on the firm and consumer credit reports on each of the principals;
- Check with the local consumer protection agency or Better Business Bureau for any complaints about the builder; and
- Talk to other homeowners about their experiences with the builder.

B. Pre-Construction Conference

Once the contractor has been selected, the Agency, the applicant, the designer (if applicable), and the contractor should hold a pre-construction conference. The purpose of the conference is to ensure that each party understands their respective roles and responsibilities. The parties should review the drawings and specifications to make sure everyone understands the scope of work, construction/thermal standards, environmental mitigation requirements, materials, inspection, change orders, and payment procedures.

For new construction, the Loan Originator should provide Exhibits F and G of RD Instruction 1924-A to the contractor at or before the preconstruction conference. These exhibits give details on the completion assurance (surety) that the contractor can elect to obtain. The Loan Originator also should provide the “...*And Justice for All*” poster, which explains the requirements of applicable fair labor standard laws to the contractor to post at the construction site. 

The Loan Originator should prepare an agenda before the meeting and take minutes during the meeting. All parties should review and sign these minutes to indicate their approval. The Loan Originator may use *Form RD 1924-16, Record of Pre-Construction Conference*, as a basis for preparing the agenda and recording the minutes, but the form itself is not a required document.

To prepare for loan closing, the contractor and applicant should undertake any pre-construction activities necessary to ensure that construction can begin shortly after closing. This might include getting building permits and lining up material suppliers.

C. Construction Contract

For new construction, a written construction contract is always required. Written contracts are strongly recommended for all rehabilitation-related construction, and are required if there is construction work involved that would affect the dwelling's structural integrity (otherwise, a rehabilitation plan with cost estimates and specifications may be used). The applicant and contractor must sign the construction contract at the loan closing, or within 5 business days after closing.

The Agency is not a party to this contract; however, the Agency provides many forms that should be used and attached to the contract, including:

- *Form RD 1924-6, Construction Contract;*
- *Form RD 400-1, Equal Opportunity Agreement;*
- *Form RD 400-3, Notice to Contractors and Applicants; and*
- *Form RD 400-6, Compliance Statement.*

D. Department of Labor Notification

For contracts greater than \$10,000, the Loan Originator must prepare a letter within 10 days after the contract is signed to notify the U.S. Department of Labor of the execution. The letter notifies the U.S. Department of Labor of the contract period and amount, and the contractor's name, address, and employer identification number. Exhibit C of RD Instruction 1901-E provides a format for the Loan Originator to use.



5.23 CONSTRUCTION PERIOD

Once the construction contract is in place, construction can begin. All construction work should be inspected periodically in accordance with RD Instruction 1924-A to ensure that the work is done properly. An adult member of the household should attend all inspections and be available to sign checks for the work performed.



A. Qualified Inspector

Construction work may be inspected by the Loan Approval Official or a qualified third party. A qualified third party includes a State-licensed inspector who inspects property according to a model code acceptable to the Agency, or an inspector certified by one of the following:

- International Congress of Building Officials (ICBO);
- Southern Building Code Congress International, Inc. (SBCCI);
- Building Officials and Code Administrators International, Inc. (BOCA); and/or
- Council of American Building Officials (CABO).

If inspections are conducted by a third party, the inspector should submit periodic inspection reports to the Agency (as described below). In the case of a county building inspector, the Loan Originator should request copies of the inspector's reports to be maintained in the file.

B. Periodic Inspections

The number and timing of inspections varies by the type and extent of work performed.

- **New construction and rehabilitation.**

The Agency's inspector may conduct as many inspections as necessary, but a minimum of 3 generally are required: (1) footings while under construction; (2) after the dwelling is framed-in; and (3) a final inspection once all work is complete. In some cases, such as when rehabilitation only involves replacing a roof, the footing inspection is not required.

After each inspection, the inspector should complete and maintain in the file *Form RD 1924-12, Inspection Report*.



Borrower's Responsibility for Inspection

The borrower is responsible for making inspections to protect his or her interest. The Agency's inspections are not intended to assure the borrower that the house is built according to the approved plans and specifications.



Existing, Newly Constructed Dwellings

If the borrower is purchasing an existing dwelling that was newly constructed, the Agency may accept the dwelling as "decent, safe, and sanitary" as long as the contractor provides a Certificate of Occupancy.

Paragraph 5.23 Construction Period

- **Minor rehabilitation.** All rehabilitation work must be inspected, but the Agency does not prescribe guidelines for inspecting rehabilitation work that does not involve new construction (such work might include repairing walls, painting, or installing carpet). The inspector should inspect the work at intervals that are appropriate for the extent of the repair work. Each Field Office should set its own schedule for inspections. The Loan Originator should maintain a record of the inspections conducted with the results. The inspector may use *Form RD 1924-12*, or another format that provides comparable information.
- **Environmental requirements.** If environmental mitigation measures are required, the Agency's inspector should follow up on the implementation of such measures and document compliance on *Form RD 1924-12*. Noncompliance with environmental mitigation measures should be reported to the Loan Originator and State Environmental Coordinator promptly.

C. Partial Payments

Partial payments for work completed can be issued after each inspection. The contractor and Loan Originator establish a draw schedule before loan closing. This schedule identifies when partial payments may be made, based on the amount of work completed. The amount of the payment is typically based on the value of the work, according to Exhibit A of RD Instruction 1924-A, or the Marshall and Swift guidelines. To ensure that all work will be satisfactorily completed, 40 percent of each payment request is typically withheld until the work is complete and final payment is made, as described in Paragraph 5.24. The amount withheld can be reduced to 10 percent if the contractor obtains a Surety Bond, Performance Bond, or Payment Bond, but this is extremely rare.

Example - Partial Payments

A contractor submits a payment request for \$25,000 for work completed. The loan official prepares a payment for \$15,000 (60 percent of the request), and withholds \$10,000 (40 percent).



D. Changes During Construction

If changes to the approved drawings and specifications are required during construction, the applicant and contractor must sign *Form RD 1924-7, Contract Change Order*. All modifications must be certified on *Form RD 1924-25, Plan Certification*, if the modification is regulated by the applicable development standard. Before signing it, however, the Loan Approval Official must review and sign the change order to ensure that the change fits within the approved loan amount. If the change order does not fit within the approved loan amount, several courses of action are possible:

- If the change is necessary and the borrower has repayment ability, the Agency may make a subsequent loan for the amount required to pay for the change;
- The scope of work may be scaled back to accommodate the change;
- The Agency may increase the loan amount if it can be supported by the appraisal, the cost of the property remains below the applicable section 203(b) limit, and the borrower has repayment ability; or
- The borrower may be required to provide additional cash.


The environmental review for the project must be amended if there are changes to plan and specifications during construction (with or without the provision of additional financial assistance), which will alter the purpose, operation, location, or design of the project as originally approved.

5.24 CONSTRUCTION CLOSEOUT

Once construction and rehabilitation work is satisfactorily completed, the Agency will make final payment to the contractor. Before that can occur, the Loan Originator must ensure that the work has been done properly and that no one will make any claims against the property (such as dissatisfied subcontractors). The Agency provides several forms to help the Loan Originator close out the construction process, as listed below.

- **Certificate of Contractor's Release.** *Form RD 1924-9, Certificate of Contractor's Release* must be signed by the contractor; it certifies that the work has been completed according to the drawings and specifications and the Agency's standards.
- **Release by Claimants.** The contractor must have each subcontractor used during construction sign *Form RD 1924-10, Release by Claimants*. It certifies that the contractor has paid each subcontractor and that there are no outstanding claims against the property for work performed.
- **Builder's warranty.** A warranty is a guarantee of the quality of work or materials. The Agency must have a copy of 1 of the 2 acceptable forms of builder's warranties as listed below (the applicant keeps the original).

Paragraph 5.24 Construction Closeout

- ◇ *Form RD 1924-19, Builder's Warranty* is a 1-year warranty provided to the borrower by the contractor after the construction work has been accepted by the borrower and the Agency. A builder's warranty is issued for new construction (or rehabilitation involving construction) that has had appropriate periodic inspections conducted by the Agency (or third party). The warranty guarantees that the builder will repair or replace any defects in materials or construction that occur within 1 year from the date of acceptance. CSC will be responsible for notifying the borrower of the expiration of the builder's warranty within eleven months of acceptance of the final inspection.
- ◇ An insured 10-year warranty, as described in Exhibit L of RD Instruction 1924-A, is an insurance policy issued by a third party. It is purchased by the builder and insures the borrower against builder defaults and/or major structural defects. This policy is typically used when the borrower is purchasing an existing, newly constructed dwelling and the Agency does not have acceptable documentation of construction quality. 
- **Other documentation.** The Agency should maintain the following documentation, if applicable:
 - ◇ Certificate of Occupancy (in some localities, a certificate of occupancy from the local regulatory agency is required before a new or renovated structure may be occupied);
 - ◇ Copies of building permits;
 - ◇ *Form RD 1924-25, Plan Certification*;
 - ◇ Certifications regarding the adequacy of all systems, as described in Paragraph 5.7 A.; and
 - ◇ Additional certifications and warranties, including insulation, carpet, and major appliances.

5.25 SPECIAL SITUATIONS

A. Funds Remaining After Completion

When all planned construction or rehabilitation work has been completed, remaining loan funds may be used for any additional authorized loan purposes agreed upon by the applicant and the Agency. The Loan Originator must document the purposes for which the funds disbursed to the borrower will be used. The Loan Originator should adjust the development plan accordingly. Once the work is complete, the Loan Originator should maintain documentation of the work performed, such as invoices and receipts for materials, equipment or supplies. If no agreement can be reached, the Agency should apply the funds to the borrower's outstanding principal balance.

B. Construction Work that Cannot be Completed

If construction or rehabilitation work cannot be completed because the contractor is unable or unwilling to do so, and the applicant is unable to obtain another contractor (even with the Agency's assistance), funds should be applied to reduce the borrower's principal balance.

C. Deceased Borrowers

If a borrower dies before funds are disbursed for completed construction or rehabilitation work, the Loan Originator may authorize payment for work completed when there is written evidence (such as a letter) that the work was accepted as complete and satisfactory by the borrower or an authorized representative, and an authorized Agency representative has inspected the work and found it satisfactory. The authorized representative can endorse the check on behalf of the deceased borrower. If there is no authorized representative or the contractor files a mechanics lien, advice from the Office of the General Counsel (OGC) should be sought to ensure the Agency's interests are protected.

D. Compensation for Construction Defects

For newly built dwellings, the Government may pay for major defects in dwelling construction that are not repaired adequately by the builder (such defects are usually the result of poor workmanship and the contractor refuses to repair the defect or the repairs are inadequate). To be eligible, the borrower must submit a claim to the Field Office within 18 months after the date the borrower signs the final inspection report. Guidance on how to notify borrowers of this policy, as well as instructions on how to implement the policy, can be found in RD Instruction 1924-F. This option should only be used as a last resort after all other actions to correct the defects have failed.



ATTACHMENT 5-A

CHECKLIST FOR INITIAL ASSESSMENT OF EXISTING HOUSING

Applicant's Name	Property Address
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This checklist can be used for an initial assessment of an existing dwelling. Check "Yes" or "No" to indicate whether each element is in satisfactory condition. If an element does not exist, note "NA" in the comments column. If you need additional space to describe your observations, use the attached comment sheet.

Yes	No		Comments
		1. Streets. The site is accessible from a hard surfaced or all weather road in compliance with local requirements.	
		2. Walks and Driveway. The driveway is adequate. The walks pose no safety hazard.	
		3. Utilities. The house has adequate, safe, dependable utilities with sufficient easements.	
		4. Foundation. The foundation is sound, with no evidence of subsidence and with no cracks, or evidence of moisture intrusion into basements, slabs, or crawlspaces. The grade at the foundation provides positive drainage away from the house.	
		5. Exterior Walls. Exterior walls do not exhibit signs of structural fatigue, failure, or excessive bowing. The siding is free of any rot or paint that is loose, peeling, chipping, scaling, or cracking. Vinyl or aluminum siding is free of mildew. Brick or stone veneer is sound and exhibits no displacement.	
		6. Exterior Doors And Trim. All exterior doors, including sliding doors, have functional locks. All exterior doors are in good repair, including hardware.	
		7. Garages. The garage is in sound condition with no obvious defects. The garage door is functional. If the garage is an attached garage the required 1 hour fire wall is in place and properly maintained.	
		8. Porches/Decks. The porches/decks are sound with no deterioration.	

Yes	No		Comments
		9. Roof. The roof is free of leaks. The existing roof is expected to last for a minimum of 5 years.	
		10. Gutters And Downspouts. The gutters and downspouts are installed properly with splashblocks at the end of each downspout.	
		11. Framing. Floor, subflooring, ceiling joists, and partition framing are sound and exhibit no structural deficiencies.	
		12. Interior Walls And Ceilings. The walls and ceilings exhibit no bowing, sagging, or obvious defects. Wallcovering is adequate, with no loose, scaling, peeling, or chipping paint.	
		13. Interior Doors And Trim. The doors are free of holes and other serious damage. Trim is sound, with no broken or missing pieces.	
		14. Windows. The windows are functional and adequate. There is no broken or cracked glazing, or loss of glazing compound, and all windows are lockable. Bedroom windows meet egress requirements.	
		15. Floor Covering. The floor covering is not damaged, heavily worn, or soiled. The existing floor covering is expected to last for a minimum of 5 years.	
		16. Cabinets And Vanity. The kitchen cabinets and counter tops are sound, with functional doors and drawers. The bathroom vanity is sound, with functional doors and drawers.	
		17. Stairs. All stairs are sound and exhibit no structural deficiencies. All stairs with 3 or more risers have a handrail.	
		18. Plumbing. The plumbing is functional and adequate.	
		19. Heating And Air Conditioning. The heating and air conditioning, including exhaust fans, are functional and adequate.	
		20. Electric Wiring. The electrical components are functional and adequate.	
		21. Insulation. The insulation is adequate.	
		22. Sump Pumps. All sump pumps are functional and in compliance with local regulations.	
		23. Pests. The house is free of termites and other wood damaging pests and organisms.	
		24. Miscellaneous. Any other factors that are noted during the assessment.	

Inspected By

Date

NOTE: Any problems identified must be cured with loan funds or before loan closing.

Item Number	Additional Comments

ATTACHMENT 5-B
SINGLE FAMILY HOUSING SITE CHECKLIST

Applicant's Name

Property Address

Name of Subdivision: _____

Note: If the answer is "YES," provide comments and discuss with the appropriate State Office technical staff (Architect, Engineer, or State Environmental Coordinator) for further evaluation and guidance. The presence of any of the following conditions must be considered in the appraised value.

1. SITE SUITABILITY, ACCESS, AND COMPATIBILITY WITH SURROUNDING DEVELOPMENT

Has the site been used as a dump, sanitary landfill, or mine waste disposal area? () Yes () No

Is there indication of:

	<u>Yes</u>	<u>No</u>		<u>Yes</u>	<u>No</u>
distressed vegetation	()	()	oil/chemical spills	()	()
waste material/containers	()	()	abandoned machinery, cars,		
soil staining, pools of liquid	()	()	refrigerators, etc.	()	()
loose/empty drums, barrels	()	()	transformers, fill/vent pipes,		
			pipelines, drainage structures	()	()

Are there other unusual conditions on site which might indicate potential for contamination from hazardous waste, hazardous substances, or petroleum products? () Yes () No

Note: Complete a Transition Screen Questionnaire, if a "YES" answer is given to any of the above three items, before proceeding further with this application.

Is the site compatible with surrounding area in terms of:

	<u>Yes</u>	<u>No</u>		<u>Yes</u>	<u>No</u>
Land use	()	()	Building type	()	()
Height, bulk, mass	()	()	Building density	()	()

Will the site be unduly influenced by:

	<u>Yes</u>	<u>No</u>		<u>Yes</u>	<u>No</u>
Building deterioration	()	()	Transition of land uses	()	()
Postponed maintenance	()	()	Incompatible land uses	()	()
Obsolete public facilities	()	()	Inadequate off-street parking	()	()

2. SOIL STABILITY, EROSION, AND DRAINAGE

Slopes: () Not applicable () Steep () Moderate () Slight

Is there evidence of slope erosion or unstable slope conditions on or near the site? () Yes () No

Is there evidence of ground subsidence, high water table, or other unusual conditions on the site?
() Yes () No

Is there any visible evidence of soil problems (foundations cracking or settling, basement flooding, etc.) in the neighborhood of this site? () Yes () No

Have soil studies or boring been made for the site or the area? () Yes () No () Unknown

Do the soil studies or boring indicate marginal or unsatisfactory soil conditions? () Yes () No

Is there indication of cross-lot runoff, swales, drainage flows on the property? () Yes () No

Are there visual indications of filled ground? () Yes () No

Are there active rills and gullies on site? () Yes () No

If the site is not to be served by a municipal waste water disposal system, has a report of the soil conditions suitable for on-site septic systems been submitted? () Yes () No () Not Applicable

3. NUISANCES AND HAZARDS

Will the site be affected by natural hazards:

	<u>Yes</u>	<u>No</u>		<u>Yes</u>	<u>No</u>
Faults, fracture	()	()	Fire hazard materials	()	()
Cliffs, bluffs, crevices	()	()	Wind/sand storm concerns	()	()
Slope-failure from rains	()	()	Poisonous plants, insects, animals	()	()
Unprotected bodies of water	()	()	Hazardous terrain features	()	()

Will the site be affected by built hazards and nuisances:

	<u>Yes</u>	<u>No</u>		<u>Yes</u>	<u>No</u>
Hazardous street	()	()	Railroad crossing	()	()
Dangerous intersection	()	()	Inadequate screened		
Through traffic	()	()	drainage catchments	()	()
Inadequate separation			Hazards in vacant lots	()	()
of pedestrian/vehicle traffic	()	()	Chemical tank-car terminals	()	()
Traffic way	()	()	Other hazardous chemical storage	()	()
Inadequate street lighting	()	()	High-pressure gas or liquid		
Quarries			petroleum transmission		
or other excavations	()	()	lines on site	()	()
Dumps/sanitary landfills or			Overhead transmission lines	()	()
mining	()	()	Hazardous cargo		
Heavy industry	()	()	transportation routes	()	()
Incinerators	()	()	Oil or gas wells	()	()
Power generating plants	()	()	Industrial operations	()	()
Oil refineries	()	()	Cement plants	()	()

Will the site be affected by nuisances:

	<u>Yes</u>	<u>No</u>		<u>Yes</u>	<u>No</u>
Gas, smoke, fumes	()	()	Unightly land uses	()	()
Odors	()	()	Abandoned vehicle	()	()
Vibration	()	()	Vermin infestation	()	()
Vacant/boarded-up			Industrial nuisances	()	()
buildings	()	()	Other _____	()	()

4. WATER SUPPLY, SANITARY SEWERS, AND SOLID WASTE DISPOSAL

Is the site served by an adequate and acceptable:

water supply () Yes () No () Municipal () Private;

sanitary sewers and waste disposal systems () Yes () No () Municipal () Private;

and trash collection and solid waste disposal () Yes () No () Municipal () Private.

If the water supply is non-municipal, has an acceptable “system” been approved by appropriate authorities and agencies?

☐ Yes ☐ No

If the sanitary sewers and waste water disposal systems are non-municipal, has an acceptable “system” been approved by appropriate authorities and agencies?

☐ Yes ☐ No

5. NOISE ABATEMENT

Is the site located near a major noise source, i.e., civil airports (within 5 miles), military airfields (15 miles), major highways or busy roads (within 1000 feet), or railroads (within 3000 feet)? ☐ Yes ☐ No

If yes, complete a noise assessment before proceeding further with this application.

6. AIRPORT HAZARDS

Is the project within 3,000 feet from the end of a runway at a civil airport? ☐ Yes ☐ No

Is the project within 2-1/2 miles from the end of a runway at a military airfield? ☐ Yes ☐ No

7. OTHER CONDITIONS

Are there any field conditions not specified above that would adversely affect the acceptability of the lots/sites? ☐ Yes ☐ No

Inspected By

Date

ITEM NUMBER	ADDITIONAL COMMENTS

ATTACHMENT 5-C
AMENDMENTS TO MORTGAGES WITH LEASEHOLD INTEREST

The following paragraphs must be inserted in the mortgage. The first paragraph should be placed directly before the legal description of the real estate.

“All Borrower’s right, title, and interest in and to the leasehold estate for a term of ____ years beginning on _____, 19____, created, executed and established by certain Lease dated _____, 19____, by _____, Page ____ of ____ Records of said County and State, and any renewals and extensions thereof, and all Borrower’s right, title, and interest in and to said Lease, covering the following real estate.”

“Borrower will pay when due all rents and any and all other charges required by said Lease, will comply with all other requirements of said Lease, and will not surrender or relinquish, without the Government’s written consent, any of Borrower’s right, title, or interest in or to said leasehold estate or under said Lease while this instrument remains in effect.”